

**B. Any Forward-Looking Cost Model Will Severely Discourage Rural Infrastructure Development And Violate The Act.**

The Recommended Decision proposes a transition to forward-looking costs for universal service funding for Rural LECs after 3 years. ¶¶ 184, 264, 275, and 277. Specifically, the model is to include a criteria that:

Technology assumed in the model should be the least-cost, most efficient and reasonable technology for providing the supported services that is currently available for purchase . . .

¶ 277(1)

With respect to the use of forward-looking costs, the Recommended Decision reads in part:

We find that forward-looking economic costs should be used to determine the cost of providing universal service. Those costs best approximate the cost that would be incurred by an efficient competitor entering that market. We believe that support should be based on the cost of an efficient carrier and should not be used to offset the costs of inefficient provision of service . . .

¶ 270. As discussed further below, use of such technology cannot be achieved in reality, with the result that real investments needed to serve real customers will either be: 1) under recovered and discouraged; or 2) local rates will increase, irrespective of affordability. Two unreasonable assumptions are reflected in for the use of forward-looking costs.

**1. Attempting to Determine the Costs of a New Entrant to the Market Is Misdirected in Rural Areas.**

The first unreasonable assumption is that the appropriate cost level is that of an efficient competitor “entering that market.” While this assumption may have some reality in some urban areas, it is unlikely that there will be new market entrants in many rural areas. In most rural areas, the providers of universal service are unlikely to be new entrants to the market. Rather, for Rural areas, the primary providers of universal service will not be the new competitors, but rather

the incumbent Rural LECs. A model that is based on determining the costs of a market entrant that does not exist and then using those costs to set rates for incumbent providers will have little chance of approximating the actual costs of the incumbent. It is critical to note that it is the actual costs of the incumbent that will determine the prices charged to customers and whether those prices meet the criteria of affordability and comparability in the Act.

**2. The Technological Efficiency Assumptions of the Forward Looking Cost Model Cannot Be Achieved By Any LEC, Much Less A Rural LEC.**

The technological efficiency assumptions of the forward looking cost model are also unrealistic for any LEC providing real service to real customers and are particularly inappropriate for Rural LECs, given their small size and periodic investments resulting from that size.

Forward looking cost models will systematically understate actual costs and lead to under-recovery of actual investments for any LEC that must serve the needs of customers as those needs arise. The technology used by any LEC with universal service obligations will always be a combination of older, less efficient technology and newer, more efficient technology. Forward looking cost models would ensure perpetual under-recovery of future investments because it is clear that technology available today will always be less expensive and more efficient than what an incumbent Rural LEC was able to purchase yesterday.

A Model's reliance on the cost of today's most efficient technology would guarantee a systematic under-recovery of investments made by Rural LECs to serve actual customers even though those were the best possible investments when made.

**3. Systematic Under-recovery of Prudent Investments Based on Subsequent Changes in Technology Will Discourage Rural Investment.**

A systematic under-recovery of investments clearly violates the requirement of Section 254(b)(5) that universal service support be “sufficient” to achieve “affordable rates.” Such an under-recovery will also discourage investments by Rural LECs contrary to the goal of Section 254(b)(2) to encourage the delivery of advanced services in rural communities.

This risk is most severe for Rural LECs because their investments are “lumpy” in that relatively large percentage conversions of facilities occur at irregular intervals. A review of available data demonstrates that per subscriber net investments of Rural LECs fluctuate widely. This reflects the fact that upgrades are not continuous and involve large portions of a Rural LEC’s facilities when they are made.

While a larger LEC may be able to partially “hedge” the risk of ongoing technical advance by gradual additions to its network, a Rural LEC, which has only a few exchanges, must make major commitments to technology at irregular intervals. With major commitments of capital being made in reliance on a given level of technology, the risk of a subsequent change in that technology is compounded. As a result, the forward looking cost assumption imposes far greater risks upon Rural LECs and will undermine affordable rates and discourage rural infrastructure development.

**C. The Recommended Freeze Of Support Levels Will Also Discourage Current Investments By Rural LECs And Violate The Act.**

The Recommended Decision includes a freeze of per line support for Rural LECs at current levels, including DEM weighting, high cost support and long-term support for three years, followed by a three year transition to a proxy model. ¶¶ 184, 272, 283, and 289. The

freeze in support at current levels, combined with a freeze in DEM weighting, high cost support and long-term support levels, will deny many high-cost Rural LECs an opportunity to recover investments that should be made at the present time to serve current, real customers.

Many Rural LECs, faced with the need to make current investments necessary to provide quality service, would find that the costs of those investments would **not** be supported because support has been frozen at current levels per line and the current proxy models are admittedly not reliable for Rural LECs. Absent an increase in customer line counts, which would generate additional support, the investments needed to provide quality service to current customers would not be recovered except through increases in customers rates. If investments that are needed for quality service are not supported, the requirement of Section 254(b)(3) that universal service support be “sufficient” is violated.

## **V. THE ACT DOES NOT LIMIT UNIVERSAL SERVICE GOALS TO SINGLE LINES IN PRIMARY RESIDENCES OR BUSINESSES.**

The Recommended Decision proposes to deny USF support to services provided to secondary residences, second lines to primary residences and to multi-line businesses. ¶¶ 90, 91. These recommendations violate the requirements of the Act.

### **A. The Act’s Protections for Consumers in High-Cost And Rural Areas Are Not Limited to Primary Residences or Single Line Businesses.**

The recommendation of the Joint Board would redefine and narrow the protections that Congress intended by imposing additional requirements to receive the protections intended for high-cost areas. Specifically, for residential customers, the Joint Board would exclude from eligibility all but primary residences and single lines to those residences. For business customers, the Joint Board would grant eligibility to only single-line businesses.

The Act does not intend to limit the benefits of universal service to primary residential lines and single line businesses. To the contrary, the Act intends that the high-cost provisions of the Act shall apply to **all “consumers”** in high cost areas. Section 254(b)(3) reads in part:

Consumers in all regions of the Nation, including low-income consumers **and** those in rural, insular, and high cost areas, should have access to telecommunications and information services, including interexchange services and advanced telecommunications and information services, that are reasonably comparable to those services provided in urban areas and that are available at rates that are reasonably comparable to rates charged for similar services in urban areas.

There are two categories of consumers that are beneficiaries under the Act: 1) “low-income consumers”; and 2) “consumers . . . in rural, insular and high cost areas.” While additional protections are extended to a particular class of customers (customers with low incomes), there is no Congressional intent to deny support to all consumers in high-cost areas so that rates between rural and urban areas remain “reasonably comparable”. The Joint Board recommendation would violate this intent.

In addition, if requirements being suggested by the Joint Board are implemented, they will have unintended effects on the rates that Rural LECs must charge for services that are no longer supported. The Act clearly mandates that in rural and high cost areas, the rates charged to all customers for all services are to be both “affordable” and “reasonably comparable” to those charged in urban low-cost areas. The Rural LECs will continue their efforts to deliver these services at rates that meet the Act’s other mandates. But without support, the inevitable result will be either a rise in rates that must be charged for all services or additional charges imposed on second lines, secondary residences and multi-line businesses in these already high-cost areas. Thus, the unintended effect of the boards recommendations will be the Rural LEC rates for these services are not “reasonably comparable” as required by the Act.

**B. The Act's Protection of Interexchange Rates For All Customers Is At Odds With The Joint Board's Recommendation.**

The Act also shows the intent to protect all customers in Section 254(g), which requires geographically averaged long distance rates for the benefit of **all** customers, reading in part:

[T]he commission shall adopt rules to require that the rates charged by providers of interexchange telecommunications services to subscribers in rural and high cost areas shall be no higher than the rates charged by each such provider to its subscribers in urban areas.

There is no indication that Congress intended that such benefits be limited to “primary residents” or “single-line businesses.” Congress could have readily limited the protections to such subscribers, but instead applied the protection to **all** subscribers in rural and high cost areas.

Such an approach indicates a Congressional intent that universal service protections be available to **all** persons within rural and high-cost areas. The Joint Board's proposals to eliminate support for secondary residences, second lines and multi-line businesses all violate this intent.

**C. Elimination Of Support For Secondary Residences In Rural LEC Areas Will Violate The Requirement of the Act that Funding Be “Sufficient” and “Predictable”.**

The Recommended Decision would deny support for the costs of serving secondary residences. ¶ 90. Many Rural LECs, including many members of the Minnesota Independent Coalition, serve areas that have a disproportionately high population of retirees and residences which are occupied for less than a full year. Elimination of support for secondary residences will impose a disproportionate burden on these Rural LECs in violation of the requirements of Section 254(b)(5) that support mechanisms be predictable and sufficient to preserve and advance universal service. The inevitable result would be one of the following: 1) an increased burden on other customers of the Rural LEC; 2) an under-recovery of investment by the Rural LEC

prudently made to provide universal services; or 3) attempts to impose higher rates on secondary residences, which will lead to customers misreporting their status that Rural LECs will be unable to monitor or prevent. Any of these results would violate the requirements that universal support be sufficient and predictable.

The requirement of sufficiency would be violated because elimination of the support for residences that were previously eligible for support would reduce the levels of support received without any corresponding reduction in expenses. Investments made to provide service to customers are not eliminated when the status of the customer changes from full-time resident to part-time resident or when the customer moves away from the residence. In both cases, the investment remains even though the customer's choice would deny recovery of federal support. If support is denied, increased burdens on all other customers may result.

The requirement of predictability would also be violated because support received by the Rural LEC would depend on the decisions of its customers who may either change their residence status or move away from a residence previously occupied. Rural LECs would not know from one period to the next whether support levels would change, based solely on the decisions of customers.

If support for secondary residences is not included, the level of USF support for Rural LECs would turn on their subscriber's determinations about their "residence" status. These determinations would be made subjectively, and they would be subject to unpredictable change. As a result, Rural LECs would not know, from period to period, whether the costs of their investments would be supported. The resulting confusion and uncertainty clearly violates the predictability requirement of the Act.

Elimination of support for secondary residences may lead Rural LECs to attempt to impose higher rates for customers based upon whether they are part-year or full-year residents. Clearly, such a step by Rural LECs would encourage misreporting of resident status by customers which would be extremely difficult for the Rural LECs to prevent. Rural LECs are in no position to monitor the living habits of their customers to verify claims that a residence is “primary”, even though unoccupied for various portions of the year. Accordingly, the recommendation to limit support to only a primary residence is unworkable and should not be adopted.

**D. Elimination Of Support For Second Lines Would Violate The Requirement of the Act That Funding Be “Sufficient” and “Predictable”.**

The Recommended Decision also would deny recovery for second lines into residential locations. ¶ 89. Again, a Rural LEC would be faced with the prospect that investments that were supported when made may lose that support if used by the customers for different purposes. The use of the lines is outside of the control of the Rural LEC and is, accordingly, not predictable.

Further, such a practice would likely discourage LECs from installing sufficient facilities to accommodate second lines, which would contribute to a decline in the quality of service and/or an increase in costs for other customers.

The unrecovered cost of the Rural LEC’s investment will remain after the removal of support for secondary lines. Loss of such support will encourage Rural LECs to impose additional charges on secondary lines. If the reduced support level is not sufficient to recover these operating costs, Rural LECs will be forced to raise rates for secondary lines (or to shift the cost recovery burden to other, already high cost services). Secondary line rate increases would



further discourage their use or encourage misreporting by residential customers attempting to maintain more than one line at the lower single-line rate. These consequences of the Joint Board's recommendation would violate the Act's sufficiency and predictability requirements for support mechanisms; and they would violate the Act's separate requirement that rates for universal service in areas served by Rural LECs be "affordable" and "reasonably comparable" to the rates in urban areas.

**E. Elimination Of Support For Two-Line Businesses Will Also Violate the Requirement of the Act That Funding Be "Sufficient" and "Predictable".**

The Recommended Decision also would eliminate support for businesses with two or more lines. ¶¶ 91, 92. This characteristic would also make the Rural LECs' level of support dependent upon the choice of its customers, even though neither the Rural LECs' costs nor investments would change. Investments which receive support when a business had only a single line would lose support when a second line was added. The result would be that either: 1) other customers of the Rural LEC would experience an increase in burden; or 2) the Rural LEC would be denied recovery of investments in technology that were prudent and the most efficient when made.

Such a practice would also encourage the application of additional charges for businesses with second lines. Once again, if the reduced level of support fails to insure cost recovery, Rural LECs will be forced to recover costs from other sources, including rate increases for businesses with multiple lines. Rate increases will, in turn, discourage the use of multiple business lines (and thereby retard infrastructure development), or they will encourage misreporting by business customers (e.g. by using phantom or shell businesses to obtain more than one line at the lower, single-line rate). These unintended consequences of the Board's proposal to restrict USF

Support would, once again, violate not only the Act's sufficiency and predictability requirements for USF support mechanisms, but also the "affordability" and "comparability" requirements that rates be "affordable" and "reasonably comparable" between rural and urban areas.

**F. Conclusion.**

For the reasons discussed above, the Commission should:

1. Continue to provide support to rural LECs based on actual costs, rather than forward looking costs;
2. Eliminate the freeze on actual cost levels and DEM weighting, long term support and high cost support; and
3. Allow support for costs incurred to serve secondary residences, second lines and businesses with more than two lines.

**VI. COMPETITIVE BIDDING IS CLEARLY INAPPROPRIATE FOR RURAL LEC AREAS AND DOES NOT MERIT FURTHER STUDY.**

The Recommended Decision concludes that the record does not support adoption of any specific competitive bidding proposal. ¶ 341. However, the Joint Board also recommends that the Commission and States continue to investigate methods to structure a fair and effective competitive bidding system. ¶ 349.

The Joint Board supports competitive bidding because it is a "market based approach," ¶ 342; it would put all prospective eligible carriers on a "equal footing," ¶ 342; and it could reduce the "amount of overall support needed for universal service," ¶ 343. The Recommended Decision states that a system should be "competitively neutral and not favor either the incumbent or new entrant." ¶ 345.

For the reasons set forth below, competitive bidding for Rural LEC areas is inconsistent with the Act. Accordingly, the cost and resources needed to further study competitive bidding for Rural LEC areas should not be expended.

**A. Advantages Asserted For Competitive Bidding Are Inapplicable To Rural LEC Areas.**

A review of the advantages asserted for competitive bidding demonstrates that such advantages can only be present, if at all, **when there are multiple ETCs** for an area. Competitive neutrality cannot be a factor **unless** there is more than one competitor (for receipt of universal service funding). Competitive bidding is an effective means of setting and/or controlling prices **only** if there is more than one bidder. As the Act indicates, neither of these conditions may exist in many areas served by Rural LECs.

Section 214(e)(2) clearly indicates that there is no presumption that there be multiple ETCs in areas served by Rural LECs, reading in part:

Upon request and consistent with the public interest, convenience and necessity, the State commission **may**, in the case of an area served by a rural telephone company, and **shall**, in the case of all other areas, designate more than one common carrier as an eligible telecommunications carrier. . . . Before designating an additional eligible telecommunications carrier for an area served by a rural telephone company, the State commission shall find that the designation is in the public interest.

(Emphasis added.)

The difference in standards for designation of multiple eligible telecommunications carriers in Rural areas and other areas is confirmed in the Conference Committee Report which reads in part as follows:

If the area for which a second carrier requests designation as an eligible telecommunications carrier is served by a rural telephone company, then the State commission **may only designate an additional carrier as an eligible**

**telecommunications carrier if the State commission first determines that such additional designation is in the public interest.**

(Emphasis added.)

These provisions reflect Congress' intent that a different approach be taken for areas served by Rural LECs than for other areas. The Recommended Decision concerning competitive bidding fails to take these differences into account. For these reasons and the reasons discussed below, further study of competitive bidding in Rural LEC areas would be wasteful.

**B. Bidding For Universal Service In Rural LEC Areas Would Be Inconsistent With the Requirement of the Act That Funding Be "Sufficient."**

As discussed above, a primary advantage attributed to competitive bidding is its supposed ability to reduce the level of USF support (§ 343) in a manner that is competitively neutral (§ 345). Competitive neutrality and efforts to reduce support levels are subject to the requirement that universal service support be sufficient to achieve affordable rates.

Section 254(b) reads in part:

The Joint Board and the Commission shall base policies for the preservation and advancement of universal service on the following principles.

...

(5) there should be specific, **predictable and sufficient** federal and state mechanisms to preserve and advance universal service.

(Emphasis added.)

Sufficient funding of universal service in Rural LEC areas will require that the **actual cost** of providing the services be appropriately funded. Mechanisms, such as bidding, which are designed primarily to reduce the level of support provided, are particularly inconsistent with the requirement of "sufficient" funding for Rural LEC areas.

The submission of an aggressive bid, based either on new technology or selective use of the Rural LECs' facilities, would necessarily diminish the level of support received by the Rural LEC, increasing costs and rates for its remaining customers. Submission of an aggressive bid and willingness accept a lesser support level by no means assures quality service.

**C. Competitive Bidding For Rural LEC Areas Would Be an Inconsistent Requirement of the Act That Funding Be "Predictable."**

Competitive bidding for Rural LEC areas also compounds uncertainties for Rural LECs. If competitive bids are to be useful in setting the level of USF support, periodic bids have to be conducted at regular intervals. Each successive bid could lead to a reduction in a Rural LEC's USF support. The prospect of recurring reductions in funding would make a Rural LEC's decision to invest in infrastructure even more hazardous than a forward-looking cost model. The risk to small and thinly capitalized Rural LECs of aggressive bidding by well capitalized CLECs, who may be able to absorb underfunding for significant periods of time, is even greater than the risks posed by technological change that is inherent in a forward looking cost model. Such risks are completely inconsistent with the Act's requirement that funding be "predictable."

For the foregoing reasons, competitive bidding for rural LEC areas is clearly inappropriate and inconsistent with the Act and does not merit further study.

**VII. EXISTING SPECIAL PRICES AND ARRANGEMENTS FOR QUALIFIED SCHOOLS AND LIBRARIES SHOULD BE ELIGIBLE FOR USF SUPPORT.**

While the Joint Board focused primarily upon the implementation of future arrangements for providing discounts to schools and libraries, it also recognizes that special, discounted pricing arrangements for the benefit of schools and libraries already occur. ¶¶ 477 and 533. The Joint Board also recognizes the need for flexibility for schools to make their own arrangements for the

services that they need. ¶¶ 440, 458, 460, and 462. The Joint Board also recommends that existing discounts obtained through State requirements or private contracts should qualify for support. ¶¶ 571 and 572. Each of these recommendations is appropriate.

**A. Support For Existing Arrangements Is Required To Avoid Discrimination.**

Support for existing discount programs is particularly important to Minnesota schools and Rural LECs, which have been among the leaders in the implementation of two-way video services between school locations, high speed data transfer, and Internet access services. At this time, approximately 200 of Minnesota's 400 school districts use interactive video to enhance course offerings, many of which benefit from discounted rates. In addition, an extensive project (the Telecommunications Access Grant project) involving over 470 schools and library sites and over 50 LECs, is being implemented. This project will provide internet access and data and video services. Again, discounted rates are being provided by LECs.

Such pricing is consistent with existing policy in Minnesota, which has also authorized discounted rates for basic telephone services. See Minn. Stat. §§ 237.065 and 124C.74.

These programs should receive USF support for services provided after the USF support program is activated. Most such arrangements were either established on a competitive bid basis or otherwise received close scrutiny by State regulatory agencies or State funding sources. Such existing discount arrangements are in the public interest and should not be retroactively disqualified by newly established discount arrangements. To the contrary, such arrangements should be presumed to be eligible for funding upon the joint request of the schools and the LECs involved.

**B. Retroactive Application Of Eligibility Criteria Would Be Inappropriate.**

It is critical that progressive LECs and schools, such as found in Minnesota, not be disadvantaged by a retroactive application of rules for eligibility for universal service support.

Specifically, the Recommended Decision should be clarified to provide that the competitive bidding requirements, including the requirement for posting of RFPs by the Fund Administrator, not be imposed on existing discount arrangements.

The Recommended Decision recognizes that schools should not be required to abandon existing contracts. The Recommended Decision reads in part:

We recommend that the Commission not require any schools or libraries that had secured a low price on service to relinquish that rate simply to secure a slightly lower price produced by including a large amount of federal support.

At ¶ 572. This recognition should be clarified further by **specifically exempting** existing arrangements from the procedural requirements imposed on new projects, including competitive bidding, including the submission of requests to the Fund Administrator, for posting on the Internet and notice to all carriers certified in the area. ¶¶ 539 and 601. Exemption is appropriate because compliance with these requirements on a retroactive basis would result in the loss or termination of the existing arrangements, contrary to the recommendation of the Joint Board.

**C. Existing Arrangements Should Be Qualified On An Expedited Basis.**

Once the school funding program is implemented, services provided under existing arrangements should be funded from the new pool upon a reasonable demonstration by the schools and LECs that the prices received by the schools are below the “lowest corresponding price,” which the Recommended Decision defines as, “the lowest price charged to similarly situated non-residential customers for similar services.” ¶ 540.

**D. Funding Of Various States Should Be Initially Allocated On A Per Capita Basis.**

The Joint Board Recommends that up to \$2.25 Billion in discounts be made available to schools each year (§ 556); and that the amount of the discount should be greater if the school is “economically disadvantaged” as shown by the school’s Federal school lunch program enrollment or some other objective indicator of economic need (§ 563 and 564). The Joint Board’s recommendations do not, however, offer any assurance against: 1) exhaustion of the available funds due to disproportionate claims from certain areas to the exclusion of others; or 2) discrimination against States that have adopted a progressive approach to the use of technology in schools.

To protect against these possibilities, there should be a first priority allocation of funds based on an objective indicator of relative economic need among the States. The Joint Board recognizes that enrollment in the national school lunch program is “the least administratively burdensome” way of gauging economic disadvantage. (§ 564) Claims to the total amount potentially available for this program (\$2.25 billion) could be tentatively allocated to each State based on the total school lunch enrollment or other indicator. This allocation should be available to schools in the service area on a priority basis, and should be made available to schools in other States only if the priority claims are not exercised within some reasonable time.

**VIII. USF SUPPORT TO CLECS IN RURAL LEC AREAS SHOULD NOT BE BASED ON THE RURAL LEC’S COSTS, AND SHOULD NOT INCLUDE FUNDING FOR RESOLD SERVICES.**

The Recommended Decision proposes that USF payments to Rural LECs be “portable,” so that either the Rural LEC or the CLEC should receive the same per access line level of USF payment based on the Rural LECs’ costs. §§ 296 and 297. The Recommended



Decision is also not clear concerning the critical question of whether the CLEC may receive USF payments for services provided through resale.

An undeniable goal of USF is to promote affordable telecommunications service. Section 254(b)(1). To accomplish that goal, it is necessary to provide support payments for part of the cost of providing service in high-cost areas. The Act recognizes that multiple recipients of USF support may not be appropriate in Rural LEC areas. Section 214(e)(1). Certainly, the Act does not permit CLECs to obtain an uneconomic advantage over Rural LECs based on the methodology used to make USF payments. For the reasons set forth below, the Act requires that: a) CLECs not be allowed to recover USF for resold services; and b) USF payments to CLECs must not exceed the CLEC's cost of providing service.

**A. USF Payments Should Be Made Only To The Underlying Provider Of Facilities.**

The purpose of USF is to pay part of the cost of providing qualified services. That cost is based on the cost of the **facilities** needed to provide the service. Under Section 214(e), a CLEC may be designated an ETC if it offers:

[T]he services that are supported by Federal universal service support mechanisms under section 254 (c), either using its own facilities or a combination of its own facilities and resale of another carrier's services (including the services offered by another eligible telecommunications carrier)  
...

A CLEC need not provide all of its own facilities in order to qualify as an ETC, but it must provide **some** of its own facilities. A CLEC should not recover USF funds for the cost of the services that it merely resells.

If the LEC providing the facilities receives USF payments, those payments will reduce the retail rates, which equally benefits: 1) the LEC's retail customers; 2) the reseller (which receives the advantage of the LEC's supported retail rates); and 3) the customers of the reseller. Directing the USF payments to the LEC providing the facilities will: a) provide payment to the party **incurring the cost** of providing the service; and b) provide the benefits of the USF funds on a **competitively neutral basis**.

If, however, USF payments are shifted from the Rural LEC to a reseller, the reseller would receive a "double" benefit from USF that would violate the Act. This double benefit would result from the combination of: 1) purchase of service for resale at a price supported by USF; and 2) receipt of the payment that is intended to support an affordable retail rate. In addition, the LEC would be deprived of the USF payment intended to support the retail rate at an affordable level and would incur the entire cost of the facilities without support. Such a situation would confer on the reseller an unfair cost advantage not intended by the Act.

Such a diversion of support to the reseller would also result in the CLEC having a lower cost of service for resold services than was intended under the Act. The Act intended the LEC to offer resale either based on the retail rate [Section 251(b)(1)] or based on the retail rate less the avoided cost [Section 252(d)(3)]. To allow a reseller to recover USF payments would be equivalent to providing the CLEC with an impermissible added discount not intended by the Act.

**B. USF Payments To CLECs Should Not Be Based On The Rural LECs Embedded Costs.**

The Recommended Decision proposes that CLECs, regardless of their cost of service, receive the **same** per line USF payment as the Rural LEC (based on the Rural LEC's embedded costs). The Recommended Decision asserts that "competition would best be served" by this proposal. ¶ 296. It is further asserted that providing a CLEC with the same level of contribution per access line provided to a LEC would be administratively easier. ¶ 297.

To the contrary, competition will be distorted if USF payments to a CLEC are based on the Rural LEC's costs because these costs are likely to be far in excess of the CLEC's actual costs. Further, administrative convenience can not justify the unfair competitive advantage CLECs would receive under this proposal.

**1. Providing CLECs With "Portable" USF Support Based on a Rural LEC's Embedded Costs Would Violate the Act.**

The Recommended Decision proposes that Rural LECs be allowed to use the frozen embedded investment cost per line to calculate their USF support levels for a period of three years. ¶ 289. The Recommended Decision also proposes that these payments be "portable" and that CLECs be allowed to recover the same amount per line as the LEC is allowed to recover, with payment to the Rural LEC being reduced by a corresponding amount. ¶¶ 296 and 297. This policy, if adopted, would lead to USF payments to a CLEC that are far in excess of the CLEC's cost of service and would violate the Act.

Under the Recommended Decision, USF payments to Rural LECs will be based on embedded investment costs, frozen at current levels. Due to improved and lower cost

technology, CLECs will be able to make corresponding facilities investments at a lower per unit cost. For example, a CLEC making a current investment in a switch can be expected to have a lower per unit switching cost than the LEC with an embedded switching investment. As a result, using the LEC's embedded cost for determining the CLEC's USF payment is likely to result in a payment far in excess of the CLEC's cost and to provide a windfall to the CLEC while reducing the Rural LEC's payment by more than the corresponding reduction in cost. This would provide the CLEC with a significant and unfair competitive advantage over the Rural LEC. Such a result would be completely inconsistent with the intent of the Act.

The purpose of the USF is to provide cost support. If the support is less than would be justified by the CLEC's costs, the payment is inadequate. Conversely, payments in excess of the needed cost support would be uneconomic, discriminatory subsidies. Because such payment to CLECs' would far exceed the CLECs costs, the Act will not allow the Commission to make USF per line payments based on Rural LEC costs portable to a CLEC.

## **2. Administrative Convenience Does Not Justify Violation of the Act.**

It is asserted that using the LEC's embedded cost as a proxy for the CLEC's cost would be administratively convenient. ¶ 297. It is probable, however, that any investments made by CLECs to serve Rural areas would be limited and that the costs incurred by the CLECs to provide services would be relatively easy to determine. Further, the State commissions could determine an appropriate cost estimate for any CLEC that sought designation as an ETC under Section 214(e)(1). Accordingly, administrative convenience does not justify the windfall support levels that CLECs would receive if their support payments are based on Rural LECs' embedded costs.

**C. Conclusion.**

The Recommended Decision's proposal, in ¶¶ 296 and 297, that a CLEC receive the same USF payment per access line paid to a LEC, should be rejected. Payment should not be portable to the CLECs for resale of the Rural LECs services. Payments should be limited to those services provided by the CLEC using some or all of its own facilities and should be based on the CLEC's cost of providing the service.

**IX. PAYMENTS TO SUPPORT THE FEDERAL USF SHOULD BE BASED ON A CARRIER'S RETAIL REVENUES.**

The Recommended Decision proposes funding USF supported discounts to schools, libraries, and rural health care providers based on an interstate telecommunications provider's gross revenues from both interstate and intrastate services, **less** the amount paid to other carriers. ¶¶ 12 and 807. The proposal that the surcharge apply to gross revenues **net** of any amount paid **to** another telecommunications carrier would result in unfair competitive advantages to the CLECs and disadvantages to LECs, in violation of the Act. As explained below, the appropriate formula would apply the surcharge to all retail revenues.

**A. Reducing the Basis for Funding by Payments to Other Carriers is Discriminatory.**

Allowing a reduction for payments to other carriers violates the requirement of Section 254(d) that contributions must be obtained "on an equitable and non-discriminatory basis".

The proposal to allow an offset for any payments made **to** another carrier is clearly discriminatory and would systematically impose greater burdens on carriers using more of their own facilities. A pure reseller, for example, would be largely exempt from the

surcharge because virtually all of its costs are for use of another carrier's facilities, which would be removed from the funding base for the surcharge. Only that portion of the reseller's revenues related to the reseller's own costs and profit would be subject to the surcharge. A facilities based carrier, with comparable customers, would have a much higher funding base.

A comparison of the impact on two hypothetical carriers demonstrates the discrimination inherent in the proposal to reduce the required contribution by payments made to other carriers.

Carrier A, which uses all of its own facilities, has revenues of \$1 Million. It has expenses of \$500,000 relating to the operation of its facilities, but makes no payments to other carriers. Its USF funding obligation would be based on \$1 Million.

Carrier B is primarily a reseller that competes with Carrier A. It too has revenues of \$1 Million, but has \$500,000 of payments to other carriers for the use of their facilities. Under the proposal, its USF funding obligation would be based on \$500,000, and it would be required to make only one-half of Carrier A's USF payments.

This difference in the USF payment obligations of two directly competing carriers remains the same whether intrastate revenues are included or excluded, whether the payments are for resale of retail services or for unbundled network elements, and is clearly discriminatory, inequitable, and in violation of the Act.

If implemented, the end result of the recommendation would be that the vast majority of the costs of supporting USF would be borne by the LECs. Burdened with a higher USF surcharge, more LEC customers can be expected to shift to CLECs where the USF surcharge

is lower. As this occurs, the USF surcharge imposed on the remaining LEC customers would become even greater. The irony of this situation is that a high cost LEC, for whom the program was designed, could be harmed rather than helped by this program, and the intended benefit of reducing the LEC's rates to keep them affordable would be significantly reduced.

**B. Double Payments Can be Prevented by Applying the Surcharge to Only Retail Revenues.**

The Recommended Decision based its proposal on the desire to prevent the “double payment problem.” ¶ 252. The desire to avoid a double USF contribution from the same service is reasonable and can be easily accomplished by applying the surcharge to gross retail revenues, excluding payments from other carriers. Further, this change is required to meet the Act's requirement to apply an “equitable and nondiscriminatory” contribution.

By imposing the surcharge solely on the basis of retail revenues, both the LECs and the CLECs would be subject to the same level of contribution for the same volume of competitive retail business obtained. Whether applied to a reseller, a partial facilities-based carrier or a LEC, the contribution would be based on the revenues received from **end users and would be competitively neutral**. The amount each carrier must recover would be a fixed percentage of the rate charged to the end user. As a result, the prices charged for providing the service, rather than the amount of the USF surcharge, would remain the basis for customer selection between carriers.

**C. Conclusion.**

Applying the surcharge to gross revenues net of payments to other carriers would be discriminatory in violation of Section 254(d) of the Act. Instead, the contribution should be applied to interstate revenues received from end users.

**X. THE REQUIRED SERVICE AREAS FOR CARRIERS SERVING RURAL LEC AREAS SHOULD BE THE EXISTING STUDY AREAS.**

The Recommended Decision supports retaining the existing study areas as the service areas for Rural LECs. ¶¶ 134, 172, and 174. This recommendation is appropriate and should be adopted by the Commission for several reasons.

First, the Joint Board recommendation is consistent with Section 214(e) which is intended to protect Rural LECs from the risk of federal funding of “cherry picking.” Section 214(e) requires an ETC to serve a Rural LEC’s entire service area as a precondition to being designated an ETC and receiving federal universal service funding. Retaining the existing study areas as the Rural LEC service areas properly supports the goal of preventing destructive “cherry picking.” ¶¶ 172 and 173.

Second, the Recommended Decision is consistent with the priority of the Act that competition in Rural LEC areas should not occur in a manner that will not harm universal service.

The clear priority given to universal service in Rural LEC service areas is evident in the provisions of the Act that allow States to require any competitor in a Rural LEC service area to satisfy the service obligations of an ETC. Subsection 253(f) provides:

It shall not be a violation of this section for a State to require a telecommunications carrier that seeks to provide telephone exchange service or



exchange access in a service area served by a rural telephone company to meet the requirements in section 214(e)(1) for designation as an **eligible telecommunications carrier for that area before being permitted to provide such service**. This subsection shall not apply--

- (1) to a service area served by a rural telephone company that has obtained an exemption, suspension, or modification of section 251(c)(4) that effectively prevents a competitor from meeting the requirements of section 214(e)(1); and
- (2) to a provider of commercial mobile services.

(Emphasis added.) The two exceptions to the discretion granted to the States do **not** include competitive neutrality or the opening of all markets to competition. Clearly, these goals must be subordinate to the goal of universal service in Rural LEC service areas, if the requirements of the Act are to be met.

The priority of universal service is also apparent in the provisions of the Act that expressly allows State commissions to name a **single** universal service support recipient in areas served by Rural LECS and imposes conditions **before** a State commission may authorize a second provider to receive USF support. Section 102(a) of the Act, adding new Section 214(e)(2), reads in part:

Before designating an additional eligible telecommunications carrier for an area served by a rural telephone company, the State commission shall find that the designation is in the public interest.

The Report of the Conference Committee makes it clear that the designation of a second eligible carrier for areas served by rural telephone companies is subject to specific findings of the State commissions. The Report reads in part:

If the area for which a second carrier requests designation as an eligible telecommunications carrier is served by a rural telephone company, then the State commission **may only** designate an additional carrier as